Scarsdale Investment Group, Ltd.

All Bond Portfolios

# Dreams and Reality: Market Performance 2020

*Hildy Richelson and Stan Richelson*
*Newsletter, February 25, 2020*

**Old Wall Street Expression: Don't confuse genius with a bull market.**

With the stock market currently hitting all-time highs, the bull market 11 years old, and all stock market non-professional individual investors feeling smart and happy, we interrupt the party and suggest that this is a good time to consider the words of a famous song.

Kenny Rodgers on the album, *The Gambler,* had a sophisticated view of poker which may be applicable to the stock market as well. Knowing when to fold 'em is an historic and international theme. Kenny addressed that issue and made that phrase famous when he wrote the chorus of the song lyrics entitled "The Gambler":

> You got to know when to hold 'em, know when to fold 'em
> Know when to walk away and know when to run
> You never count your money when you're sittin' at the table
> There'll be time enough for countin' when the dealing's done.

Although everyone agrees that putting your money in the stock market is an investment, and fiscally responsible, yet it has all the trappings of high stakes gambling. People talk about how well they have done investing in the stock market, but they have not yet taken their chips off the table. How do unrealized gains in stock investing differ from sitting at the table in Las Vegas with a pile of chips that you have just won?

There are many stories that repeat this theme throughout history.[i] It is the dream of poor people dreaming of wealth, only to find themselves in a worse situation than when they started because they did not focus on the present moment. It is an international theme with many variants. There is the story of the milkmaid who plans to sell her milk and buy eggs. From the eggs she will get chickens. She will sell her chickens and buy a new frock… Only to unbalance the milk, break the crock and have nothing. In the U.S. we have the saying: Don't count your chickens before they're hatched.

## 1929 Fear of Redo

Jason Zweig,[ii] book author and writer for *The Wall Street Journal*, took a deep dive and look at the Crash of 1929. Even today, the bottom line is that no one knows why the crash happened when it did or what caused it. There are hypotheses as to the why, but no one predicted the timing of the event or its length and severity. It took 25 years – a quarter of a century until the Dow surpassed it's 1929 high on November 23, 1954. Zweig notes that does not include the reinvestment of dividends, which most investors would have taken as cash. He notes that in a 1954 survey by the Federal Reserve, only 7 percent of households said they preferred stock over savings bonds, bank accounts or real estate.

Zweig asks: After a major crash, what is the prospect of staying in the market until it rebounds? His answer:

> Only if you have the patience of a tortoise and the emotions of a stone. Catastrophic losses are rare, but their risk never goes away…To be a long-term investor in stocks, you have to be prepared to lose more money for longer than seems possible. Anyone who takes that risk lightly is likely to sell out in the next crash, near the bottom.[iii]

Eric Hickman, president of Kessler Investment Advisors, Inc, an investment firm specializing in U.S. Treasury bonds, seems to think that a recession is likely in 2020, despite good economic news. Five long-running recession indicators, including Yield Curve Inversion, Jobs Gap Growth Negative, Leading Economic Indicators Peak, Initial Jobless Claims Trough, ISM Manufacturing First Below 50%, all point to a coming recession in 2020.[iv] Many more believe that a recession is highly likely to occur within two years.

Triggers to Financial Meltdown

What is the cause of a major financial meltdown? What precipitates the bottom dropping out of the market? How do you decide if this moment is coming? The economist, Hyman Minsky, determined that the key trigger to a downdraft is a surge in leveraged speculation that finally unbalances the system. This occurs when investors borrow on margin – when they have a negative balance in their bank or stock accounts because they borrowed to bet on the market direction of some asset. Corporations do this by taking on loans and individuals borrow against their assets.

Lance Roberts of Real Investment Advice[v] in an article written for *Advisor Perspectives*, believes that the Federal Reserve is facilitating the current economic expansion by taking on more debt and lowering interest rates, thus facilitating "speculative risk taking in the financial markets" that will lead to the Minsky Moment.

Nouriel Roubini of Project Syndicate acknowledges the possibility of the Minsky Moment, but also points to possible "white swans, which are predictable and more like hurricanes – " [vi] According to Nassim Nicholas Taleb, in his book *The Black Swan*, there are white swans, or issues we can identify, and black swans, issues that we do not know about and cannot anticipate. Mr. Roubini focuses on the impact of climate change, as well as four countries that are actively trying to destabilize the American economy and political milieu, namely North Korea, Russia, Iran and China. Actions instigated by any of these countries could prove economically, financially, politically and geopolitically disastrous, he states. Those are the white swans he sees, and then, there are the black swans which are the unknown unknowns.

COVID-19, now renamed SARS-CoV-2 may prove to be a black swan – a rare and inherently unforeseeable event with severe consequences that is playing out in the year 2020. As a result of widespread illnesses and death, fearful countries, like Austria, close their borders. Chinese business and travel tourism have all but stopped and global airlines and cruise lines are not going to China. Supply chains are being disrupted because Wuhan, the epicenter of the disease, is a major Chinese transportation and distribution hub. Apple, Nike and General Motors are prominent examples of businesses that source from China. Many businesses do not have back up supply chains. That may mean price spikes on goods from Walmart and Amazon among others.

Conclusion

An old Chinese adage warns that: A tall tree attracts the wind, and the Wall Street saying is: Trees don't grow to the sky. Two different ways of saying the same thing: You need to sell to realize your gains.

Before a market downdraft comes, you might consider the following issues:

- When do you sell to take your gains? Answer: No one knows or wants to sell too early.
- Do you actually have a gain before you sell and close your position? Answer: No, this is clear.
- What is the cost of closing your position? Answer: Taxes, fees, bad feelings if you miss the top.

Can you ever close your position? Ah, there is the rub. The general answer is that while many believe they can time the market, there are few if any documented cases of individual investors moving in and out and having a system to time the market accurately.

It is the received knowledge that when the market goes down, it always come back up. However, individual investors contemplating or in retirement may not be able to comfortably stay in the game.

Are you going to leave your chips on the table, or take your money and run?

---

[i] "The milkmaid and her pail." *Wikipedia*.

[ii] Jason Zweig. Everything You know About the Crash Is Wrong. *The Wall Street Journal*. October 26-27, 2019.

[iii] Zweig, October 26-27, 2019.

[iv] Eric Hickman. A Recession Is More Likely Than You Think. *AdvisorPerspectives.com* January 13, 2020.

[v] Lance Roberts. Macro View: The Next "Minsky Moment" Is Inevitable. *AdvisorPerspectives.com*. February18, 2020.

[vi] Nouriel Roubini. The White Swans of 2020. *AdvisorPerspectives.com.* February 18, 2020.